

ASC 606: Accounting for Long-Term Contracts

🔑 Core Principle

Revenue is recognized **when or as the customer obtains control** of the asset:

- **Over time** → Revenue is recognized progressively as work is performed.
- **Point in time** → Revenue is recognized only when the performance obligation is fully satisfied.

🏠 Common Types of Long-Term Contracts

- Construction projects (buildings, infrastructure, bridges, dams)
- Government and military defense contracts
- Aerospace projects (aircraft, spacecraft, satellites)
- Bundled deliveries (e.g., staged delivery of office furniture or IT systems)

✅ Criteria for Over-Time Recognition

Revenue is recognized over time if **any one** of the following criteria is satisfied:

Criteria	Description	Example
1 Simultaneous benefit	Customer receives and consumes benefit as service is performed	Office cleaning, annual maintenance contracts
2 Customer controls WIP	Customer controls the asset while it's being built	Constructing a building on customer-owned land
3 No alternative use + right to payment	Asset is custom-made and company has enforceable right to payment	Custom machinery, military submarine, tailored software

👉 If **none** of these criteria are met, revenue must be recognized at a **point in time** (similar to the “completed contract method” under legacy GAAP).

💡 ASC 606 vs. Legacy GAAP: Revenue Recognition for Long-Term Contracts

Aspect	ASC 606 (Over-Time)	Legacy GAAP (Percentage-of-Completion)
Basis	Transfer of control	Cost-based % completion
Judgment Required	High – principles-based	Moderate – rules-based
Revenue Recognition	May differ from cost % completion	Usually aligns with cost % completion

🔍 Key Differences Explained

1 Basis of Recognition

- **ASC 606** → Focuses on **transfer of control** of goods/services.
- **Legacy GAAP** → Relied on **cost-to-cost percentage completion**, assuming cost incurred = performance progress.

2 Judgment and Estimation

- **ASC 606** → Principles-based. Requires management to exercise judgment to measure **actual progress** (e.g., engineering milestones, deliverables, inspections).
- **Legacy GAAP** → Rules-based. Often defaulted to **percentage of costs incurred** as a proxy for progress.

⚠️ **Example:** A project is 50% complete in cost but only 30% complete in deliverables.

- Under **Legacy GAAP** → 50% revenue would be recognized.
- Under **ASC 606** → Revenue should reflect **30% actual completion** of deliverables, not just costs.

3 Revenue Recognition Timing

Under **ASC 606**, revenue is recognized **over time** only if one of the following applies:

1. Customer receives and consumes benefits as work is performed.
2. Customer controls the asset as it is being built.
3. The asset has no alternative use, and the company has a right to payment.

👉 If none apply → Use **point-in-time recognition**, meaning revenue is recognized **only at delivery** (similar to completed contract method).

🔴 Point-in-Time Recognition

- Used when none of the over-time criteria are met.
- Revenue is recognized **only when control transfers** (e.g., warehouse handed over).
- Similar in effect to the **completed contract method** under legacy GAAP (but the term is no longer used in ASC 606).

🏠 Practical Scenario

Contract Details

- A construction company enters into a **₹10,00,000 contract** to build a warehouse.
- Total expected cost = **₹8,00,000**
- Project duration = **2 years**
- Year 1 cost incurred = **₹4,00,000**
- The customer cannot use the partially built warehouse until it's substantially complete.

Recognition under Legacy GAAP (Cost-to-Cost % Completion)

- Progress = Cost incurred ÷ Total cost = ₹4,00,000 ÷ ₹8,00,000 = **50%**
- Revenue recognized in Year 1 = 50% × ₹10,00,000 = **₹5,00,000**
- Expense recognized = **₹4,00,000**
- Profit recognized = **₹1,00,000**

Recognition under ASC 606 (Transfer of Control)

- Must determine: *Does the customer obtain control during construction?*

Case A: Control transfers over time

- Criteria met (e.g., no alternative use + right to payment).
- Revenue in Year 1 = **₹5,00,000** (same as GAAP, but justified by control transfer).

Case B: Control transfers only at completion

- Criteria not met → control passes only on delivery.
- Year 1 revenue = **₹0**
- Entire ₹10,00,000 recognized in Year 2.

📊 Side-by-Side Comparison

Year	Legacy GAAP (PoC)	ASC 606 – Case A (Over Time)	ASC 606 – Case B (Point in Time)
Year 1	Revenue: ₹5,00,000	Revenue: ₹5,00,000	Revenue: ₹0
	Expense: ₹4,00,000	Expense: ₹4,00,000	Expense: ₹4,00,000
	Profit: ₹1,00,000	Profit: ₹1,00,000	Profit: -₹4,00,000
Year 2	Revenue: ₹5,00,000	Revenue: ₹5,00,000	Revenue: ₹10,00,000
	Expense: ₹4,00,000	Expense: ₹4,00,000	Expense: ₹4,00,000
	Profit: ₹1,00,000	Profit: ₹1,00,000	Profit: ₹6,00,000
Total (2 yrs)	Revenue: ₹10,00,000	Revenue: ₹10,00,000	Revenue: ₹10,00,000
	Expense: ₹8,00,000	Expense: ₹8,00,000	Expense: ₹8,00,000
	Profit: ₹2,00,000	Profit: ₹2,00,000	Profit: ₹2,00,000

✅ Key Takeaways

- Legacy GAAP** = *cost-driven, rules-based* → revenue tied directly to costs incurred.
- ASC 606** = *control-driven, principles-based* → requires evaluating when and how the customer gains control.
- Total revenue and profit **over the life of the contract** remain the same; what changes is the **timing of recognition**.

[[[📌 Legacy GAAP: Two Methods for Long-Term Contracts

Feature	Completed Contract Method	Percentage-of-Completion Method
Timing of Revenue Recognition	At the end of the contract (when completed)	Progressively , as costs are incurred
Basis of Recognition	No revenue until full performance is complete	Revenue tied to cost-to-cost % completion
Use Case	When outcome is uncertain or not measurable	When outcome is reasonably estimable

Feature	Completed Contract Method	Percentage-of-Completion Method
Revenue in Year 1 (50% cost incurred)	₹0	50% of total contract value
Risk of Misstatement	Lower (conservative)	Higher (requires estimates and judgment)
Common Industries	High-risk or uncertain contracts	Construction, aerospace, defence

Example

Contract: ₹10,00,000 to build a warehouse **Total expected cost:** ₹8,00,000 **Year 1 cost incurred:** ₹4,00,000 (50%)

Completed Contract Method

- Revenue in Year 1: ₹0
- All ₹10,00,000 revenue recognized in Year 2 when project is completed

Percentage-of-Completion Method

- Revenue in Year 1: ₹10,00,000 × 50% = ₹5,00,000
- Expense: ₹4,00,000
- Profit: ₹1,00,000

Key Takeaway

Completed Contract = conservative, wait until the end **Percentage-of-Completion** = progressive, based on cost incurred

ASC 606 replaces both with a **principles-based model** focused on **transfer of control**, which may resemble either method depending on contract terms.]]]

ASC 606: Point-in-Time Recognition for Long-Term Contracts

Core Principle

When a long-term contract **does not meet any of the criteria for over-time recognition**, revenue, cost, and gross profit are recognized **at a single point in time** — when the customer obtains **control** of the asset.

- Until that point:
 - Costs are accumulated in a **Construction in Process (CIP)** account.
 - Billings are recorded in a **Billings on Construction in Process (BCP)** account.
- At completion: Revenue = **Contract Price** – recognized in full.

Key Features of Point-in-Time Recognition

1. **No revenue/profit recognized** until the performance obligation is satisfied.
2. If a **loss** is projected at any point → recognize the **full loss immediately** (per ASC 450-20, Loss Contingencies).
3. Presentation on the balance sheet uses **net contract assets or liabilities** (CIP vs BCP).

Recognition of Losses

At each reporting period:

Estimated Profit (Loss) = Contract Price – Costs Incurred to Date – Estimated Future Costs

If a **loss is projected**: recognize the **entire estimated loss immediately**.

Journal Entry:

Dr Loss on long-term contract (I/S) xxx

Cr Construction in Process (CIP) xxx

Recognizing the Incurrence of Contract Costs

Costs incurred are accumulated in **CIP** (like WIP inventory, but with a key difference).

Journal Entry:

Dr Construction in Process (CIP) x

Cr Cash / A/P / Accrued Wages x

 Unlike manufacturing WIP, CIP does not flow into Finished Goods. Instead, it is closed out directly against Construction Expense when revenue is recognized.

Recognizing Invoice Issuance

Invoices are issued as work progresses, but **invoicing ≠ revenue recognition**.

Journal Entry:

Dr Accounts Receivable x

Cr Billings on Construction in Process (BCP) x

- **BCP** = liability account (or contra-asset to CIP).
- Reflects the builder's obligation to deliver the asset.
- this journal entry is **not** about paying for materials or inventory purchases. It's about **billing the customer** for work performed on a long-term construction contract, and it's part of the **contract accounting framework**,
- **BCP** tracks how much has been **billed** to the customer.
- **CIP** tracks how much **cost** has been incurred on the project.

✗ What It's Not

This entry is **not** related to:

- Paying for materials
- Recording inventory purchases
- Recognizing cost of goods sold

Balance Sheet Presentation

- **CIP** = asset
- **BCP** = liability

Reported as **net contract position**:

- If **CIP > BCP** → Net Contract Asset
(Reported as *Costs of in-process contracts in excess of billings*)
- If **BCP > CIP** → Net Contract Liability
(Reported as *Billings in excess of costs on in-process contracts*)

⚠ Important:

- Assets and liabilities are **not netted across all contracts**.
- Each contract is presented separately (some as assets, some as liabilities).
- Can be **current** or **non-current** depending on contract terms.

⚠ Recognizing Estimated Losses

If contract will end in a **loss**:

- Recognize **entire loss immediately**.

- In later periods, only **additional losses** (beyond what was previously recognized) are booked.

✓ Closing Out a Point-in-Time Contract

When the customer obtains control (contract complete):

Journal Entries:

1. Recognize Revenue:

Dr Billings on Construction in Process (BCP) total billings

Cr Revenue on point-in-time contracts total billings

2. Recognize Expense:

Dr Construction Expense total costs

Cr Construction in Process (CIP) total costs

Key Takeaways

- **Point-in-Time = Completed Contract logic** under ASC 606.
- Costs (CIP) and Billings (BCP) are tracked on the balance sheet until control passes.
- **Revenue/Profit** recognized only at transfer of control.
- **Losses** are recognized **immediately**, regardless of stage of completion.
- Balance sheet presentation must **segregate assets vs liabilities by contract**.

Extended Example – ASC 606 Point-in-Time (Completed Contract)

Contract Information

- Contract Price = ₹10,000,000
- Initial Estimated Total Cost = ₹7,500,000
- Contract Duration = 4 years
- Revenue recognized **only at completion (Year 4)**

Year 1 (In Progress)

- Costs incurred = ₹2,000,000

- Billings issued = ₹2,500,000
- **No revenue** recognized (point-in-time rule).

Journal Entries

1. Costs incurred

Dr Construction in Process (CIP) 2,000,000
 Cr Cash / Accounts Payable 2,000,000

2. Billings

Dr Accounts Receivable (A/R) 2,500,000
 Cr Billings on Construction (BCP) 2,500,000

Balance Sheet Impact (End of Year 1)

- CIP = ₹2,000,000
- BCP = ₹2,500,000
- Net Contract Position = ₹(500,000) Liability
- A/R = ₹2,500,000
- **P&L Impact = None**

Year 2 (In Progress)

- Costs incurred = ₹3,000,000
- Billings issued = ₹3,500,000 (cumulative billings = ₹6,000,000)
- Still incomplete → **no revenue**.

Journal Entries

1. Costs incurred

Dr CIP 3,000,000
 Cr Cash / Payables 3,000,000

2. Billings

Dr A/R 3,500,000
 Cr BCP 3,500,000

Balance Sheet Impact (End of Year 2)

- CIP = ₹5,000,000 (2m + 3m)
- BCP = ₹6,000,000 (2.5m + 3.5m)
- Net Position = ₹(1,000,000) Liability
- A/R = ₹6,000,000
- **P&L Impact = None**

Year 3 (Loss Identified)

- Additional costs incurred = ₹3,000,000 (CIP now ₹8,000,000 total).
- Billings = ₹2,000,000 (cumulative billings = ₹8,000,000).
- Revised Estimate: Total Cost = **₹11,000,000** → higher than contract price (₹10,000,000).
- Expected Loss = ₹1,000,000.

Updated Estimate

Management revises the estimate:

- **Remaining future costs (Year 4) = ₹3,000,000.**
- **So, total estimated costs = ₹8,000,000 (to date) + ₹3,000,000 (future) = ₹11,000,000.**

Compare with contract price:

- Contract Price = ₹10,000,000
- Estimated Total Cost = ₹11,000,000
- **Expected Result = Loss of ₹1,000,000**

 **ASC 606 Rule: Recognize entire loss immediately.**

Journal Entries

1. Costs incurred

Dr CIP 3,000,000
 Cr Cash / Payables 3,000,000

2. Billings

Dr A/R 2,000,000
 Cr BCP 2,000,000

3. Recognize full expected loss

Dr Loss on Long-Term Contract (l/S) 1,000,000
Cr CIP 1,000,000

Balance Sheet Impact (End of Year 3)

- CIP = ₹7,000,000 (8m – 1m loss adjustment)
- BCP = ₹8,000,000
- Net Contract Position = ₹(1,000,000) Liability
- A/R = ₹8,000,000
- **P&L Impact = Loss of ₹1,000,000**

Year 4 (Completion & Transfer of Control)

- Remaining costs incurred = ₹3,000,000 → Actual Total = ₹11,000,000.
- Billings = ₹2,000,000 (cumulative = ₹10,000,000).
- Project delivered → recognize full revenue & expense.

Journal Entries

1. Costs incurred

Dr CIP 3,000,000
Cr Cash / Payables 3,000,000

2. Billings

Dr A/R 2,000,000
Cr BCP 2,000,000

3. Recognize Revenue (at completion)

Dr BCP 10,000,000
Cr Revenue – Point-in-Time Contracts 10,000,000

4. Recognize Construction Expense (actual cost)

Dr Construction Expense 11,000,000
Cr CIP 11,000,000

Financial Statement Impacts

Income Statement

Year	Revenue	Expense	Profit/Loss
Y1	0	0	0
Y2	0	0	0
Y3	0	0	(1,000,000) loss
Y4	10,000,000	11,000,000	(1,000,000) loss – already recognized in Y3
Total	10,000,000	11,000,000	(1,000,000)

👉 Notice: No **new** loss in Y4 – the earlier provision absorbed it.

Balance Sheet (Selected Accounts)

Item	End of Y1	End of Y2	End of Y3	End of Y4
CIP	2,000,000	5,000,000	7,000,000	0
BCP	2,500,000	6,000,000	8,000,000	0
Net Position (500,000) Liab (1,000,000) Liab (1,000,000) Liab 0				
A/R	2,500,000	6,000,000	8,000,000	10,000,000

✅ Key Takeaways (4-Year Case)

- **Point-in-time rule** → no revenue until final delivery (Year 4).
- **Losses** → recognized **immediately** when expected (Year 3).
- At completion, revenue and cost flow through, but **no new P&L impact** beyond the already-booked loss.
- **Balance Sheet** in progress years shows CIP vs BCP difference (contract asset or liability).

Step-by-Step Accounting Process: Over-Time Recognition

1 During Construction → Record Costs (CIP)

Just like point-in-time contracts, actual costs are accumulated in **Construction in Process (CIP)**.

Journal Entry:

Dr Construction in Process (CIP) xxx
Cr Cash / Accounts Payable / Wages xxx

2 During Construction → Record Customer Billings (BCP)

Invoices issued to the customer are recorded as a receivable (asset) and as **Billings on Construction in Process (BCP)** (liability).

Journal Entry:

Dr Accounts Receivable xxx
Cr Billings on Construction in Process (BCP) . xxx

3 Period-End Calculations (Key Difference vs. Point-in-Time)

At each reporting date, you calculate **how much revenue, cost, and gross profit to recognize**:

a) Estimated Gross Profit (EGP)

Contract Price
– Costs incurred to date
– Estimated future costs
= Estimated Gross Profit (or Loss)

b) Percentage of Completion (POC)

Depends on chosen method:

- **Input Method (Cost-to-Cost):**
- Costs incurred to date ÷ Total estimated costs
- **Output Method (Milestones, Surveys, Deliverables, etc.):**
- Work completed ÷ Total work promised

c) Revenue & Gross Profit to Recognize (Cumulative)

Cumulative Revenue to Date = Contract Price × % Completion
Cumulative Gross Profit = Cumulative Revenue – Costs incurred

d) Current Period Recognition

Current Period Revenue = Cumulative Revenue – Revenue already recognized

Current Period Gross Profit = Cumulative GP – GP already recognized

Current Period Cost = Costs incurred in period

4 Journal Entries for Period-End Recognition

a. Recognize Revenue:

Dr Construction in Process (CIP) [for GP portion] xxx
Cr Revenue – Over-Time Contracts xxx

b. Recognize Expenses:

Dr Construction Expense xxx
Cr Construction in Process (CIP) [for cost portion] xxx

(CIP now contains both actual costs incurred and the profit recognized to date, making it a “gross” measure of progress.)

5 Balance Sheet Presentation

At any reporting date:

- **CIP – BCP = Net Contract Position**
 - If positive → Contract Asset (Unbilled Revenue).
 - If negative → Contract Liability (Over-billed).
-

6 Recognition of Estimated Losses

If estimated total costs > contract price → recognize entire expected loss immediately:

Journal Entry:

Dr Loss on Long-Term Contract xxx
Cr Construction in Process (CIP) xxx

Quick Example (Cost-to-Cost Method)

- Contract Price = ₹10,000,000

- Costs Incurred to Date = ₹4,000,000
- Estimated Remaining Costs = ₹6,000,000
- Total Estimated Cost = ₹10,000,000
- EGP = ₹0 (break-even project, no profit)

- ➔ % Completion = $4,000,000 \div 10,000,000 = 40\%$
- ➔ Cumulative Revenue = $₹10,000,000 \times 40\% = ₹4,000,000$
- ➔ Revenue to Recognize in Current Period = (Cumulative – Prior periods recognized)

✓ Main Difference vs. Point-in-Time:

- Point-in-Time → Revenue & GP only at completion.
- Over-Time → Revenue & GP progressively recognized using POC.

[[[Example: Period-End Recognition for a Construction Contract

■ Contract Details

- Total contract price: ₹10,00,000
- Total estimated cost: ₹8,00,000
- Project duration: 2 years
- Year 1 cost incurred: ₹4,00,000
- Estimated completion: 50%

[📄 Materials purchased: ₹2,50,000

📄 Labor paid: ₹1,00,000

📄 Subcontractor invoice: ₹50,000

📄 Total cost incurred: ₹4,00,000]

📄 Journal Entry: Record Costs to Construction in Process (CIP)

Dr Construction in Process (CIP) ₹4,00,000

Cr Cash ₹1,00,000

Cr Accounts Payable (Materials) ₹2,50,000

Cr Accounts Payable (Subcontractor) ₹50,000

📄 Journal Entries at Year-End

a. Recognize Revenue (Gross Profit Portion)

plaintext

Dr Construction in Process (CIP) ₹1,00,000

Cr Revenue – Over-Time Contracts ₹1,00,000

- This entry adds the **profit portion** to CIP.
- CIP now reflects **total progress to date**: costs + profit.

b. Recognize Expenses (Cost Portion)

plaintext

Dr Construction Expense ₹4,00,000

Cr Construction in Process (CIP) ₹4,00,000

- This entry moves the **costs incurred** out of CIP and into expense.

📄 CIP Account Summary After Entries

Component	Amount
Costs Incurred	₹4,00,000
Profit Recognized	₹1,00,000
Total CIP	₹5,00,000

This ₹5,00,000 represents the **gross measure of progress** on the balance sheet.]]]

■ Cost-to-Cost Input Method (Over-Time Contracts)

1 Formula for % Completion

Percentage Satisfied = $\text{Cost Incurred to Date} / \text{Cost Incurred to Date} + \text{Estimated Cost to Complete}$

⚡ Denominator = **Total Estimated Cost** at reporting date.

2 Estimated Gross Profit

Estimated Gross Profit=Contract Price–Total Estimated Cost

3 Cumulative Profit to Recognize

Total Profit to Recognize to Date = Estimated Gross Profit× Percentage Satisfied

4 Current Period Profit

Profit This Period=Total Profit to Recognize to Date–Profit Recognized Previously

5 Revenue to Recognize (Current Period)

Revenue This Period=Contract Price × Percentage Satisfied–Revenue Previously Recognized

Loss Recognition

If at any point:

Estimated Total Cost>Contract Price

→ **Recognize full loss immediately.**

Formula:

Loss to Recognize This Period=Total Estimated Loss + Profit Previously Recognized

Balance Sheet Impact

- **CIP (asset)** = Costs incurred + Profit recognized to date.
- **BCP (liability)** = Billings to date.
- **Net Position = CIP – BCP**
 - If positive → Net Contract Asset.
 - If negative → Net Contract Liability.

Long-Term Contract Accounting — 3-Year Worked Example (Loss Recognition)

Contract Details (Reference)

- Contract price (total revenue) = ₹8,000,000
- Original estimated total cost = ₹7,000,000

- Revised total estimated cost (after Y2 revision) = ₹9,000,000 → Total expected loss = ₹(1,000,000)

YEAR 1 — Initial Profit Recognized

Data:

- Costs incurred = ₹2,100,000
- Billings = ₹2,500,000
- % complete = $2,100,000 \div 7,000,000 = 30\%$
- Revenue recognized = $8,000,000 \times 30\% = 2,400,000$
- Profit recognized = $2,400,000 - 2,100,000 = 300,000$

Journal Entries:

1. Record costs:

Dr Construction in Process (CIP) 2,100,000

Cr Cash / Accounts Payable 2,100,000

2. Record billing:

Dr Accounts Receivable (A/R) 2,500,000

Cr Billings on CIP (BCP) 2,500,000

3. Recognize revenue & profit (over-time):

Dr Construction Expense 2,100,000

Dr CIP (profit component) 300,000

Cr Revenue – Over-Time Contracts 2,400,000

Income Statement (Y1)

Account	Amount (₹)
Revenue	2,400,000
Construction Expense	2,100,000
Net Profit	300,000

Balance Sheet (End of Y1)

Assets	Amount (₹)	Liabilities & Equity	Amount (₹)
CIP (Costs + Profit)	2,400,000	BCP	2,500,000
Accounts Receivable (A/R)	2,500,000	Retained Earnings (Profit Y1)	300,000

Assets	Amount (₹)	Liabilities & Equity	Amount (₹)
Total Assets	4,900,000	Total Liabilities & Equity	4,900,000

Net Contract Position:

- $CIP - BCP = 2,400,000 - 2,500,000 = (100,000) \rightarrow$ Net contract liability

Notes:

- Net contract liability = $BCP > CIP$
- No cash collections shown
- CIP includes previously recognized profit (300,000)

YEAR 2 — Loss Identified; Full Expected Loss Recognized

Data:

- Additional costs incurred = ₹3,500,000
- Cumulative costs = $2,100,000 + 3,500,000 = 5,600,000$
Management Revised remaining cost = **3,400,000** $\rightarrow$ Revised total cost = $5,600,000 + 3,400,000 = 9,000,000$
- Billings = 3,000,000
- Total expected loss = $8,000,000 - 9,000,000 = (1,000,000)$
- Profit previously recognized = 300,000

Loss to recognize in Y2:

Loss = Total estimated loss + Profit previously recognized = $1,000,000 + 300,000 = 1,300,000$

Journal Entries:

- Record costs:

Dr CIP 3,500,000
Cr Cash / AP 3,500,000

- Record billing:

Dr A/R 3,000,000
Cr BCP 3,000,000

- Recognize full expected loss:

Dr Loss on Long-Term Contract 1,300,000
Cr CIP 1,300,000

Income Statement (Y2)

Account	Amount (₹)
Construction Expense	3,500,000

Revenue (cumulative) 2,400,000

Loss on Contract (net) 1,300,000

Net Impact (Profit/Loss) (1,300,000)

Balance Sheet (End of Y2)

Assets	Amount (₹)	Liabilities & Equity	Amount (₹)
CIP (after loss write-down)	4,600,000	BCP	5,500,000
Accounts Receivable (A/R)	5,500,000	Retained Earnings (cumulative loss)	(1,000,000)
Total Assets	10,100,000	Total Liabilities & Equity	10,100,000

Net Contract Position:

- $CIP - BCP = 4,600,000 - 5,500,000 = (900,000) \rightarrow$ Net contract liability

Notes:

- Retained earnings decrease by 1,300,000 (full expected loss)
- Billings > CIP $\rightarrow$ working capital pressure
- Loss recognition is non-cash; reduces CIP and equity
- CIP AFTER LOSS, SO “RETAINED EARNINIGS CUMULATIVE LOSS” – 1 000 000

YEAR 3 — Completion / Final Closeout

Data:

- Remaining costs = 3,400,000
- Final billings = $8,000,000 - 5,500,000 = 2,500,000$

Journal Entries:

- Record costs:

Dr CIP 3,400,000

Cr Cash/AP 3,400,000

- Record final billings:

Dr A/R 2,500,000

Cr BCP 2,500,000

- Closeout (final revenue & expense):

8. Dr BCP (cumulative) 8,000,000
9. Cr Revenue 8,000,000
10. Dr Construction Expense 9,000,000
11. Cr CIP 9,000,000

Income Statement (Y3 / Closeout)

Account	Amount (₹)
Revenue	8,000,000
Construction Expense	9,000,000
Net Loss	1,000,000
Retained Earnings Impact	-1,000,000

Balance Sheet (End of Y3)

Assets	Amount (₹)	Liabilities & Equity	Amount (₹)
CIP	0	BCP	0
Accounts Receivable (A/R)	0	Retained Earnings (LOSS)	(1,000,000)
Total Assets	0	Total Liabilities & Equity	0

Net Contract Position: CIP – BCP = 0

Notes:

- All CIP/BCP balances cleared
- Total life-of-contract loss = 1,000,000 (already recognized in Y2)
- Cash collections determine actual working capital

Consolidated View — Y1 to Y3

Item / Year	Y1	Y2	Y3	Life of Contract
Revenue Recognized	2,400,000	2,400,000	Closeout→8,000,000	8,000,000
Construction Expense	2,100,000	3,500,000	3,400,000	9,000,000
Loss on Long-Term Contract	0	1,300,000	0	1,000,000
Net Profit / (Loss)	+300,000	(1,300,000)	0	(1,000,000)
CIP (end)	2,400,000	4,600,000	0	—

Item / Year	Y1	Y2	Y3	Life of Contract
BCP (end)	2,500,000	5,500,000	0	—
A/R (end)	2,500,000	5,500,000	0	—
Net Contract Asset/(Liability)	(100,000)	(900,000)	0	—
Retained Earnings (cumulative)	+300,000	-1,000,000	-1,000,000	-1,000,000

Practical / Disclosure Notes

- **Income Volatility:** Large one-time loss in Y2 reduces earnings sharply — disclose nature and reason for revision
- **Working Capital Pressure:** Billings > CIP creates net liability; cash flow stress if collections lag
- **Tax:** Recognize taxable income/loss per tax rules
- **Financial Covenants:** Sudden loss may breach debt covenants — disclose/manage
- **Presentation:** Loss in continuing operations unless contract qualifies as discontinued; disclose change in estimates per ASC 450/606

Detailed Example – 3-Year Contract

Contract Price = ₹12,000,000

Estimated Total Cost = ₹9,000,000

Estimated Gross Profit (EGP) = ₹12,000,000 – ₹9,000,000 = ₹3,000,000

Year 1

- **Cost incurred to date** = ₹2,700,000
- **Estimated cost to complete** = ₹6,300,000
- **Total estimated cost** = ₹9,000,000 (no change)

Step 1: % Completion

$$2,700,000 \div 9,000,000 = 30\% \quad 2,700,000 \div 9,000,000 = 30\% \quad 2,700,000 \div 9,000,000 = 30\%$$

Step 2: Revenue to Recognize to Date

$$12,000,000 \times 30\% = 3,600,000 \quad 12,000,000 \times 30\% = 3,600,000 \quad 12,000,000 \times 30\% = 3,600,000$$

Step 3: Profit to Recognize to Date

$$3,600,000 - 2,700,000 = 900,000 \quad 3,600,000 - 2,700,000 = 900,000 \quad 3,600,000 - 2,700,000 = 900,000$$

→ Profit Year 1 = ₹900,000

Year 2

- **Additional cost incurred this year** = ₹3,600,000
- **Cumulative cost incurred to date** = ₹2,700,000 + ₹3,600,000 = ₹6,300,000
- **Revised estimated cost to complete** = ₹2,700,000
- **Revised total estimated cost** = ₹9,000,000 (still same)

Step 1: % Completion

$$6,300,000 \div 9,000,000 = 70\%$$

Step 2: Revenue to Recognize to Date

$$12,000,000 \times 70\% = 8,400,000$$

Step 3: Cumulative Profit to Recognize

$$8,400,000 - 6,300,000 = 2,100,000$$

Step 4: Profit for Year

$$2,100,000 - 900,000 = 1,200,000$$

→ Profit Year 2 = ₹1,200,000

Year 3 (Final Year)

- **Additional cost incurred this year** = ₹2,700,000
- **Cumulative cost incurred** = ₹9,000,000
- **Total cost = Estimated cost (completed)**

Step 1: % Completion

$$9,000,000 \div 9,000,000 = 100\%$$

Step 2: Revenue to Recognize to Date

$$12,000,000 \times 100\% = 12,000,000$$

Step 3: Cumulative Profit to Recognize

$$12,000,000 - 9,000,000 = 3,000,000$$

Step 4: Profit for Year 3

$$3,000,000 - 2,100,000 = 900,000$$

→ Profit Year 3 = ₹900,000

Journal Entries

Year 1

1. Costs incurred

Dr Construction in Process (CIP) 2,700,000

Cr Cash / Payables 2,700,000

2. Billings to customer (say billed ₹3,000,000)

Dr Accounts Receivable 3,000,000

Cr Billings on Construction (BCP) 3,000,000

3. Revenue recognition

Dr Construction Expense 2,700,000

Dr Construction in Process (Profit) 900,000

Cr Revenue – Over-Time Contracts 3,600,000

Year 2

1. Costs incurred

Dr CIP 3,600,000

Cr Cash / Payables 3,600,000

2. Billings to customer (say billed ₹4,500,000)

Dr Accounts Receivable 4,500,000

Cr BCP 4,500,000

3. Revenue recognition (Cumulative revenue = ₹8,400,000; already recognized = ₹3,600,000; current = ₹4,800,000)

Dr Construction Expense 3,600,000

Dr CIP (Profit) 1,200,000

Cr Revenue – Over-Time Contracts 4,800,000

Year 3

1. Costs incurred

Dr CIP 2,700,000

Cr Cash / Payables 2,700,000

2. Billings to customer (say billed ₹4,500,000)

Dr Accounts Receivable 4,500,000

Cr BCP 4,500,000

3. Revenue recognition (Cumulative revenue = ₹12,000,000; already recognized = ₹8,400,000; current = ₹3,600,000)

Dr Construction Expense 2,700,000

Dr CIP (Profit) 900,000

Cr Revenue – Over-Time Contracts 3,600,000

Balance Sheet Impact

- **CIP (asset)** = Cost incurred + Profit recognized.
- **BCP (liability)** = Total billings to date.
- **Net Position = CIP – BCP** → shows either Contract Asset or Contract Liability.

ENDD

Q1. Point-in-Time Recognition (Completed Contract Method – ASC 606)

Data:

- Contract Price = ₹20,000,000
- Estimated Cost = ₹15,000,000
- Duration = 3 years (completion in Year 3)
- Costs Incurred:
 - Year 1: ₹5,000,000
 - Year 2: ₹6,000,000
 - Year 3: ₹5,000,000 (completion)
- Billings to Customer:
 - Year 1: ₹6,000,000

◦ Year 2: ₹7,000,000

◦ Year 3: ₹7,000,000

🔔 At end of Year 2, revised estimate of costs increases to ₹21,000,000 → project now in **loss position** (expected loss ₹1,000,000).

Required:

1. Journal Entries for each year.
2. Income Statement & Balance Sheet impacts (Year 1 → Year 3).

Solution (Key Highlights):

Year 1:

- Dr CIP 5M / Cr Cash-AP 5M
- Dr A/R 6M / Cr BCP 6M
- No Revenue, No Expense (Point-in-Time rule).
- **B/S:** CIP = 5M, BCP = 6M → Net Contract Liability = (1M).

Year 2:

- Dr CIP 6M / Cr Cash-AP 6M
- Dr A/R 7M / Cr BCP 7M
- Recognize Loss (1M):
 - Dr Loss on LT Contract 1M
 - Cr CIP 1M
- **B/S:** CIP = (5+6–1) = 10M, BCP = 13M → Net Liability = (3M).
- **I/S:** Loss = 1M

Year 3 (Completion):

- Dr CIP 5M / Cr Cash-AP 5M
- Dr A/R 7M / Cr BCP 7M
- Recognize Revenue (20M): Dr BCP / Cr Revenue 20M
- Recognize Expense (Total Cost 21M): Dr Expense / Cr CIP 21M
- **I/S:** Revenue 20M, Expense 21M, Loss = (1M)

- But remember: Already booked 1M loss in Year 2 →  No new P&L impact in Year 3.

Exam Takeaway: Under **point-in-time**, all revenue/cost deferred until completion. But **loss is recognized immediately** when identified.

■ Q2. Over-Time Recognition (ASC 606 – Step by Step)

Data:

- Contract Price = ₹12,000,000
- Estimated Total Cost = ₹9,000,000
- Costs Incurred:
 - Year 1: ₹3,000,000
 - Year 2: ₹4,000,000
 - Year 3: ₹3,500,000 (Completion)
- Billings:
 - Year 1: ₹2,500,000
 - Year 2: ₹5,000,000
 - Year 3: ₹4,500,000

 At end of Year 2, revised estimate of total cost = ₹13,000,000 → project now in **loss of ₹1,000,000**.

Required:

Compute revenue, expense, gross profit (loss), and prepare journal entries for each year.

Solution:

Year 1 (35% complete = 3/9):

- Revenue = $12M \times 33\% = 4M$
- Expense = 3M
- Profit = 1M
- JEs:

- Dr CIP 3M / Cr Cash-AP 3M
- Dr A/R 2.5M / Cr BCP 2.5M
- Dr CIP 1M / Cr Revenue 1M (Gross Profit recognized)

Year 2 (cumulative 7/13 = 54% complete):

- Revenue = $12M \times 54\% = 6.48M$
- Cumulative Expense = 7M
- Loss identified (Total Rev 12M – Cost 13M = –1M).
- Recognize full 1M Loss immediately:
 - Dr Loss 1M / Cr CIP 1M
- I/S: Year 2 Loss = (2.52M).
- B/S: CIP adjusted downward.

Year 3 (Completion):

- Actual Cost = 3.5M → Total Cost 13.5M
 - Revenue recognized = Full 12M
 - Total Loss = –1.5M
 - Already booked (1M) in Year 2 → book extra (0.5M) in Year 3.
-

Exam Takeaway: Over-time contracts recognize **revenue & costs each year**, but **entire expected loss must be booked when first identified**, then adjusted if loss grows.

■ Q3. Cost-to-Cost Input Method (GAAP, Over-Time)

Data:

- Contract Price = \$25,000,000
- Estimated Total Cost = \$20,000,000
- Costs Incurred:
 - Year 1: \$6,000,000
 - Year 2: \$8,000,000
 - Year 3: \$8,500,000 (completion)
- Billings:

- Year 1: \$5,000,000
- Year 2: \$10,000,000
- Year 3: \$10,000,000

🔔 At end of Year 2, revised cost estimate = **\$27,000,000** → Expected Loss = **\$2,000,000**.

Required:

Use cost-to-cost input method to compute revenue, expense, and journal entries.

Solution:

Year 1 (6/20 = 30% complete):

- Revenue = $25M \times 30\% = 7.5M$
- Expense = 6M
- Profit = 1.5M

Year 2:

- Cumulative cost = 14M; revised total cost = 27M → % complete = 52%
- Revenue to date = $25M \times 52\% = 13M$
- Cumulative Expense = 14M
- Expected Loss = (2M).
- Entry: Dr Loss 2M / Cr CIP 2M
- **I/S:** Loss recognized immediately in Year 2.

Year 3 (Completion):

- Actual Cost = 8.5M → Total = 22.5M (lower than revised estimate).
 - Still Loss: Total Rev 25M – Total Cost 22.5M = +2.5M Profit?
 - But under GAAP → once loss recognized, cannot reverse (conservatism).
 - So only offset entries made, no profit recognition.
 - Final Net Loss remains **(2M)**.
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✅ **Exam Takeaway:** Under **cost-to-cost input method**, profit/loss is updated each year. If total contract turns into loss → record immediately. Later improvement in costs does **not** reverse previously recognized losses.